

COMMERCE COMMISSION

DECISION NO. 311

Determination pursuant to the Commerce Act 1986 ("the Act"), in the matter of an application for clearance of a business acquisition involving:

SEALED AIR CORPORATION

and

W R GRACE & COMPANY

The Commission:

Alan Bollard
Peter Allport
Cathie Harrison

Summary of Proposal:

The merger in New Zealand of the flexible packaging businesses of Sealed Air Corporation and W R Grace & Company to be effected through the acquisition by the new public company, Sealed Air, of Sealed Air (NZ) Ltd and W R Grace (NZ) Ltd.

Determination:

Pursuant to s 66(3)(a) of the Act, the Commission determines to give a clearance for the proposed business acquisition, subject to an undertaking given by Sealed Air Corporation []].

Date of Determination:

27 November 1997

AUT/BA - S
M2354

MEMORANDUM

To: Alan Bollard
Peter Allport
Cathie Harrison

From: John Preston
Jeff Hamilton
Jane Chilcott

Date: 24 November 1997

Subject: **Business Acquisition: Sealed Air Corporation/W R Grace & Co**

[Confidential information in this report is contained within square brackets.]

THE PROPOSAL

- 1 On 3 November 1997, the Commission registered a notice pursuant to s 66(1) of the Commerce Act 1986 (“the Act”) seeking clearance for the merger of Sealed Air (NZ) Ltd (“Sealed Air”) and the flexible packaging business of W R Grace (NZ) Ltd (“Grace”).
- 2 The proposed merger forms part of a worldwide transaction to combine the packaging operations of two United States companies, W R Grace & Co and Sealed Air Corporation, to create a new public company called Sealed Air. W R Grace & Co’s shareholders will initially own 63% of the new packaging company with Sealed Air Corporation’s shareholders owning the remainder.
- 3 In New Zealand, the proposed merger will be implemented through the acquisition by the new public company of the Grace and Sealed Air packaging businesses.
- 4 Clearance is sought in accordance with s 4(3) of the Act, which extends the application of s 47 of the Act relating to business acquisitions, to acquisitions outside New Zealand affecting a market or markets in New Zealand, and involving persons resident or carrying on business in New Zealand.

THE PROCEDURES

- 5 Section 66(3) of the Act requires the Commission either to clear, or to decline to clear, a notice given under s 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. As an extension of 8 working days was agreed to, a determination is required by 27 November 1997.
- 6 This report concludes that staff are satisfied that implementation of the proposal would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in a market in New Zealand, and recommends that in terms of s 66(3)(a) of the Act, the Commission give clearance to the proposed acquisition.

THE INVESTIGATION

- 7 Staff discussed the proposal with a range of parties with interests in the flexible packaging industry. These included existing competitors and other industry participants; end users such as the New Zealand Dairy Board, AFFCO, Alliance Group, Richmond, PPCS and smaller meat companies including Phoenix Meat Company, Canterbury Meat Packers, Universal Beef Packers, Greenlea Premier Meats and Wallford Meats; the President of Viskase Corporation in the United States, Mr Dean Mefford; and Mr Bruce Dunlop, an international trade consultant identified by the applicant as a flexible packaging industry expert. Additional information was also obtained from the parties to the proposed acquisition.

THE PARTIES

Sealed Air Corporation

- 8 Sealed Air Corporation, a publicly owned US company, is a global manufacturer of a wide range of protective and specialty packaging materials and systems with operations in over 25 countries worldwide. It operates in New Zealand through its wholly owned subsidiary Sealed Air (NZ) Ltd (“Sealed Air”). Sealed Air is the holding company for Trigon Packaging Systems (NZ) Ltd (“Trigon”) and Danco (NZ) Ltd (“Danco”).
- 9 Danco supplies the bulk of Sealed Air Corporation’s product lines in New Zealand in respect of its non-food packaging activities, including the manufacture and sale of adhesives, padded and durable mailers, air cellular packaging materials and related products. The applicant submits, and Commission staff accept, that the markets for these products are unaffected by the proposed merger.

- 10 Trigon is involved in the supply of flexible packaging products primarily for the food industry and supplies machinery for flexible packaging operations. Trigon locally manufactures films, pouches and bags for food packaging. Trigon also prints and converts barrier shrink bags from plastic tubing which it imports from Viskase Corporation in the United States. [
-].
- 11 [
-].

W R Grace & Co

- 12 W R Grace & Co, a publicly owned US company, has packaging and chemical operations in countries around the world. It operates in New Zealand through its wholly owned subsidiary W R Grace (NZ) Ltd (“Grace”).
- 13 W R Grace & Co’s worldwide specialty chemicals business will be separated from the packaging business and will be carried out by a separate publicly owned company. In New Zealand, Grace’s specialty chemicals business is intended to be transferred to a new New Zealand subsidiary of W R Grace & Co. The packaging business of Grace will be retained in the existing company and will become a subsidiary of the new public company, Sealed Air.
- 14 Grace supplies flexible packaging products to the food industry under the “Cryovac” brand, locally manufacturing films, casings, bags, pouches and shrink bags.

OTHER INDUSTRY PARTICIPANTS

Viskase Corporation (“Viskase”)

- 15 Viskase Corporation, a division of Envirodyne Industries in the United States, supplies a range of flexible food packaging products around the world under various trademarks. Its principal products include vacuum shrink bags and specialty plastic films for the packaging and preserving of chilled and processed meat, poultry, seafood, and dairy products. It produces shrink film under the “Perflex” trademark, which is currently printed and converted into barrier shrink bags in New Zealand by Trigon.

16 In addition to the association with Trigon, Viskase has an association with National Supply Company Ltd for the distribution of casings and cook-in-the-bag products.

17 Sealed Air states [

].

18 [

].

Danaflex Packaging Corporation Ltd (“Danaflex”)

19 Danaflex, established in 1988, is involved in the supply of vacuum shrink bags for the food industry and the supply of flexible packaging machinery. Danaflex imports plastic tubing from American National Can Corporation, (a division of Pechiney Corporation in the United States¹), pursuant to an exclusive distribution arrangement. Danaflex prints and converts this tubing into pre-made shrink bags and also sells the tubing for use in its bagger machine, the “Danaflex Bagger”. The company began supplying barrier shrink bags for beef about four years ago, and has recently commenced supplying vacuum shrink bags for the packaging of sheepmeat.

20 The company is based near Wellington, with offices in Auckland, Christchurch and Brisbane, Australia. Danaflex has five owner directors and one major (20%) outside investor, Rangatira Investments.

Globus (New Zealand) Ltd (“Globus”)

21 Globus, established in 1949, is a subsidiary of Globus Group of Companies in Australia. It is involved in the supply of a range of packaging materials for the food industry, and the supply of a range of food ingredients including seasonings and marinades. The company’s head office is located in Lower Hutt, with premises in Auckland and Christchurch.

22 The company imports plastic tubing from Kureha in Japan, which it then prints and converts into barrier shrink bags and sells under the “Triplex” brand name. Globus’s main customers are butchers, smallgoods manufacturers, and some of the smaller meat companies. Globus is also involved in the supply of a range of machinery including vacuum packaging and thermoforming machinery.

AEP Industries (NZ) Ltd (“AEP”)

- 23 AEP is based in Auckland and supplies a range of flexible packaging products to the food industry, including barrier non-shrink packaging and modified atmosphere packaging (“MAP”) systems.² AEP is not involved in the supply of vacuum shrink bags.

Chequer Corporation Ltd (“Chequer”)

- 24 Chequer, established in 1982 and based in Auckland, has operations in both Australia and New Zealand. The company is involved in the supply of a range of flexible packaging products and services, but is primarily involved in the supply of non-shrink film packaging for food products. Chequer is not involved in the supply of vacuum shrink bags.

Securefresh Pacific Ltd (“Securefresh”)

- 25 Securefresh, also based in Auckland, is primarily involved in the supply of CAP systems to the food industry, particularly the meat companies. Securefresh is not involved in the supply of vacuum shrink bags.

Transpak Industries Ltd (“Transpak”)

- 26 Transpak, established in 1970 and based in Auckland, is owned by Containers Packaging which is a subsidiary of the Australian-based company Amcor Ltd. Transpak is involved in the manufacture and printing of specialised high barrier flexible packaging, including CAP systems, primarily for the food industry.
- 27 Transpak’s main customers are in the dairy industry, supplying plastic films for packaging cheese, milk powder, and liquid milk. It also supplies packaging to the meat industry.

Cas-Pak Products Ltd (“Cas-Pak”)

- 28 Auckland-based Cas-Pak, through its joint venture arrangement with Plastopil Hazorea in Israel, is involved in the supply of a range of flexible packaging products for the food industry including thermoform films, vacuum skin packaging and CAP systems.

Holmes Packaging (“Holmes”)

- 29 Holmes, based in Rotorua, is primarily involved in the supply of barrier flexible packaging to the dairy industry. The company is not involved in the supply of vacuum shrink bags.

THE RELEVANT MARKETS

- 30 The purpose of defining markets is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition under consideration. Identification of the relevant markets enables the Commission to examine whether the acquisition would result, or would be likely to result, in the acquisition or strengthening of a dominant position in terms of s 47(1) of the Act.
- 31 Section 3(1A) of the Act provides that:
- ... the term ‘market’ is a reference to a market in New Zealand for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them.
- 32 Markets are defined in relation to product type, geographical extent, and functional level. With the first two dimensions, market boundaries are determined by testing for substitutability in terms of the response to a change in relative prices of the good or service in question, and possible substitute goods or services. A properly defined market will include products which are regarded by buyers as being not too different (‘product’ dimension), and not too far away (‘geographical’ dimension), and are thus products to which they could switch if a small yet significant and *non-transitory* increase in price (“*ssnip*”) of the product in question was to occur. It will also include those suppliers currently in production who are likely, in the event of such a *ssnip*, to shift promptly to offer a suitable alternative product.
- 33 In addition, markets are also defined in relation to functional level. Typically, the production, distribution, and sale of products proceeds through a series of functional levels, so the functional levels affected by the application have to be determined as part of the market definition.
- 34 As stated earlier, Sealed Air (through Trigon) and Grace are involved in the supply of a range of flexible packaging products, primarily for supply to customers in the food industry. Applications for these flexible packaging products include meat, dairy products, smallgoods, seafood and other processed foods.
- 35 The applicant submits that the relevant market is that for the supply of flexible packaging materials for food products. It is argued that there are a number of suppliers of flexible packaging materials in respect of a great number of product applications in the food industry, and that although the form of machinery used to extrude film differs slightly for

the different flexible packaging materials produced, the same printing and converting equipment can be used for many different flexible packaging applications.

- 36 The applicant submits that this “supply-side” flexibility in the production of flexible packaging products is a significant competitive constraint on the conduct of any participant in any segment of the flexible packaging market, particularly as many global manufacturers have the technological know how, the resources, and the excess capacity to enter into, or increase supply to the New Zealand market.
- 37 The Commission focuses on “demand side” factors, that is on purchaser reactions, when identifying the relevant markets affected by a proposed business acquisition. From information provided by the parties to the merger and from other industry participants, it would appear that the major area of overlap that would arise from the proposed acquisition is in relation to the supply of vacuum shrink packaging distributed principally to the meat industry in the form of shrink bags, and also distributed to the dairy industry and other food companies. There will also be some aggregation of market share in relation to bone protection packaging, thermoform films, and vacuum skin packaging. Additionally, the proposal would result in the aggregation of market share in respect of the supply of flexible packaging machinery.
- 38 Bone protection packaging or “bone guard” is wrapped around bones to protect the meat’s packaging from being punctured.
- 39 Thermoform films are made from multi-layer polyolefin films, and are typically used for the packaging of cheese, pre-formed hams and pre-formed roasts. A pre-formed cavity is made with the film, into which the product is packaged. This restricts the use of thermoform films to products of a consistent size and shape.
- 40 Vacuum skin packaging is essentially display packaging, commonly using pre-formed trays. The packaging is used for small items such as shellfish, offals, and small meat cuts such as chops and steaks.
- 41 As already stated, the greatest aggregation will be in relation to vacuum shrink packaging, distributed primarily to the meat industry in the form of vacuum shrink bags. The packaging, made from a multi-layer co-extruded shrink film and suitable for a range of shapes and sizes of meat cuts, is used by the meat companies for the packaging of meat for the export market.

- 42 Vacuum shrink bags can be divided into two categories:
- barrier shrink bags - primarily used for packaging chilled meat, although the bags can also be used to package frozen meat and other processed food products; and
 - permeable shrink bags³ - used for packaging frozen meat, through which oxygen is able to penetrate allowing the meat to “bloom” to a red colour.
- 43 It is noted that while barrier shrink bags are used predominantly for chilled meat and permeable shrink bags for frozen meat, it is possible to use barrier bags for both applications. For example, PPCS has rationalised its operations and now uses only barrier shrink bags for all of its vacuum shrink packaging applications.
- 44 The applicant estimates that, of the meat sold on the domestic market, approximately [] is sold in vacuum shrink bags, with the bulk of meat sold unpackaged as quarter or carcasses to butchers and supermarkets.
- 45 In respect of meat packaged for the export market, the applicant submits that 61% of export beef is sold for hamburger type products and is not packaged in vacuum shrink bags. A further 6% is sold as carcasses which is also not packaged in vacuum shrink bags. The remaining 33% of export beef production is packaged almost entirely in barrier shrink bags. In respect of lamb exports, the applicant submits that approximately 30% of lamb is exported as carcasses. The remainder is sold as lamb cuts and is packaged in barrier shrink bags and MAP systems.
- 46 The applicant notes that there is a growing trend in the export meat industry for chilled lamb (rather than frozen lamb), resulting in an increasing demand for vacuum shrink bags. There is also a general movement away from carcasses to processed meat cuts. It was also submitted that there is an increasing movement in the meat industry away from the use of vacuum shrink bags towards MAP systems. Sealed Air estimates that up to half of the growth for export lamb packaging is for MAP systems. In addition to Trigon, the major suppliers of MAP systems in New Zealand include Securefresh and Transpak.
- 47 The applicant argues that vacuum shrink bags, MAP systems, and other non-shrink packaging products can be used to package export meat in either frozen or chilled form. However, other industry participants and end users consider that there is a separate market for vacuum shrink packaging, and that MAP systems are not directly substitutable for shrink bags. For example, many of those in the meat industry who were contacted by Commission staff pointed out that MAP systems involve different technology, and are slower and more expensive to use.

- 48 Transpak did not believe that MAP systems or gas flushed products were substitutable for vacuum shrink packaging and did not believe that customers would switch to MAP systems if there was a small yet significant and non-transitory price increase in the price for shrink packaging. It was noted that meat companies' operations are geared towards packaging meat in shrink bags, and that packaging in MAP systems would be slower and more costly. AFFCO, Richmond, Alliance and a number of smaller meat companies were also of the view that vacuum shrink packaging was in a separate market to MAP systems.
- 49 Securefresh was of the view that MAP systems involve more advanced technology than the traditional vacuum shrink technology, and that this technology is actually replacing shrink technology. Securefresh considered that MAP systems are a viable alternative to vacuum shrink packaging, and that there is a growing trend towards the use of MAP systems.
- 50 Vacuum shrink packaging is also used in the dairy industry, primarily for the packaging of cheese. From information provided by a number of flexible packaging industry participants involved in the supply of flexible packaging to dairy companies; for example, Transpak and Holmes, it would appear that the dairy industry is not as reliant on shrink packaging as the export meat industry. Non-shrink barrier packaging is also used for cheese packaging. The type of packaging used is determined by the customer's demands.
- 51 The raw materials for shrink bags are supplied by the world's largest petrochemicals and plastics manufacturers including The Dow Chemical Company and E I Du Pont De Nemours & Company.
- 52 While the applicant submits that "supply side" factors, such as the ability of existing industry participants to increase the quantity or expand the range of flexible packaging products supplied, mean that the relevant market is that for the supply of flexible packaging materials for food products in New Zealand, Commission staff do not agree. From the "demand side", it appears that vacuum shrink packaging constitutes a discrete market and so a narrower product market definition is appropriate.
- 53 It is also proposed to define narrow product markets for the other packaging products in which there will be some aggregation of market share as a result of the proposed merger.

Conclusion on Market Definition

54 For the purpose of assessing the dominance implications of the current proposal, it is concluded that the relevant product and functional markets are as follows:

- the market for the supply of bone protection packaging;
- the market for the supply of thermoform film packaging;
- the market for the supply of vacuum skin packaging;
- the market for the supply of flexible packaging machinery; and
- the market for the supply of vacuum shrink packaging.

55 The relevant geographic market is New Zealand.

ASSESSMENT OF DOMINANCE

56 Section 66(3) of the Act, when read in conjunction with s 47(1) of the Act, requires the Commission to give clearance to a proposed acquisition if it is satisfied that the proposed acquisition would not result, or would not be likely to result, in a person acquiring or strengthening a dominant position in a market. If the Commission is not so satisfied, clearance must be declined.

57 Section 3(8) of the Act states that a person is in a “dominant position” if:

... a person as a supplier or an acquirer of goods or services either alone or together with an interconnected body corporate is in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market and for the purposes of determining whether a person is in a position to exercise a dominant influence ... regard shall be had to -

(a) The share of the market, the technical knowledge, the access to materials or capital of that person ... :

(b) The extent to which that person is constrained by the conduct of competitors or potential competitors in that market:

(c) The extent to which that person is constrained by the conduct of suppliers or acquirers of goods or services in that market.

58 In reaching a view on whether a person is in a position to exercise a dominant influence in a market, the Commission considers the foregoing non-exhaustive factors and any other relevant matters that may be found in a particular case. Important factors to consider in this case include the constraint from existing competition, the viability of imports, and the countervailing market power of end users.

59 In *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554, the Court of Appeal approved the following dominance standard, adopted by McGechan J in the High Court:

...[dominance] involves more than “high” market power; more than mere ability to behave “largely” independently of competitors; and more than power to effect “appreciable” changes in terms of trading. It involves a high degree of market *control*.

60 A dominance assessment for each of the relevant markets follows.

Market for the Supply of Bone Protection Packaging

61 While implementation of the proposal would lead to some aggregation in relation to the supply of bone protection packaging or “bone guard”, this market is likely to remain competitive with numerous other companies capable of providing an effective constraint on the merged entity, including Sullivan Packaging. It is noted that bone guard is also imported into New Zealand. For example, AFFCO imports bone guard from Australia.

62 Accordingly, we consider that the proposal does not give rise to any competition concerns in relation to the market for bone protection packaging, and it is not proposed to analyse that market in any further detail.

Market for the Supply of Thermoform Film Packaging

63 While implementation of the proposed merger will result in some aggregation in the market for thermoform films, there is a number of other market participants involved in the supply of these films including Transpak and AEP. It is concluded that the proposal will not raise any dominance concerns in this market.

Market for the Supply of Vacuum Skin Packaging

64 Similarly, there will be some aggregation in the market for vacuum skin packaging products. That market is only very small in New Zealand and there is strong competition from Transpak. Therefore, it is considered that the proposed merger would not give rise to any competition concerns in relation to the market for vacuum skin packaging.

Market for the Supply of Flexible Packaging Machinery

65 Both Trigon and Grace supply flexible packaging machinery for use in conjunction with their flexible packaging materials. However, the applicant submits, and Commission

staff accept, that there is a number of machinery manufacturers worldwide who also supply this type of machinery, and either deal direct or have agents in New Zealand. For example, the “Danaflex Bagger” is supplied by Danaflex. It is also relevant to note that this machinery can be modified for use in conjunction with other suppliers’ products

66 It is therefore concluded that no competition issues arise in respect of the supply of flexible packaging machinery as a result of implementation of the proposal.

Market for the Supply of Vacuum Shrink Packaging

67 Trigon and Grace supply vacuum shrink packaging to the meat and dairy industries, and other food manufacturers. Sealed Air supplies permeable shrink bags under the “Shrinkvac” trade name and barrier shrink bags, which are manufactured by Viskase and distributed by Trigon, under the “Perflex” trade name. Grace supplies both permeable and barrier shrink bags under the “Cryovac” trade name. Vacuum shrink packaging is also supplied in New Zealand by Danaflex and Globus.

Market Shares

68 In the Commission’s view, a dominant position in a market is generally unlikely to be created or strengthened where, after the proposed acquisition, either of the following situations exist⁴:

- the merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market;
- the merged entity (including any interconnected or associated persons) has less than in the order of a 60% share of the relevant market and faces competition from at least one other market participant having no less than in the order of a 15% market share.

69 Except in unusual circumstances, the Commission will not seek to intervene in business acquisitions which, given appropriate delineation of the relevant market(s) and measurement of market shares, fall within these “safe harbours”.

70 The applicant estimates that existing competitors would have the following market shares in the vacuum shrink packaging market:

<u>Supplier</u>	<u>Market Share (approx %)</u>
W R Grace	[]
Sealed Air/Trigon	[]
Combined Entity	[]
Viskase	[]
Danaflex	[]
Globus[]	

71 Following implementation of the proposed merger, it appears that the combined entity will have a market share in excess of [] of the vacuum shrink packaging market in New Zealand, with the balance of market share held by the smaller suppliers. Clearly, this market share falls outside the Commission’s “safe harbours”.

72 Meat companies are the major end users of vacuum shrink packaging in New Zealand and the applicant estimates that the following annual sales are made to this segment of the vacuum shrink packaging market:

Supplier	Beef		Lamb	
	\$(000)	%	\$(000)	%
Trigon/Sealed Air	[]	[]	[]	[]
Grace	[]	[]	[]	[]
Viskase (through Trigon)	[]	[]	[]	[]
Danaflex	[]	[]	[]	[]
Globus			[]	[]

73 These figures illustrate that Grace has a significantly higher market share than its competitors (in relation to both beef and sheep) in this segment of the shrink packaging market. Trigon also has a large market share for the supply of shrink packaging for lamb.

74 Market shares are insufficient in themselves to establish whether a dominant position would exist in a market. As Tipping J stated in *New Zealand Magic Millions Ltd & Anor v Wrightson Bloodstock Ltd* (1990) 3 NZBLC 99-175:

... market share is not the sole determinant of the presence or absence of dominance or market power. The most that can be said is that dominance is frequently attended by a substantial market share but all other relevant factors must be brought into account. For example, a substantial market share without barriers to entry will seldom, if ever, be indicative of dominance.

75 Accordingly, the Commission considers a range of additional factors before reaching a conclusion as to the acquisition or strengthening of a dominant position in any market,

such as the constraint from existing and potential competition and barriers to entry. These additional factors are discussed below.

Constraint from Existing Competition

- 76 The applicant estimates that Danaflex, Globus and Viskase (through Trigon) have a combined market share of approximately [] in the market for the supply of vacuum shrink packaging. The applicant argues that these existing competitors have the ability to expand their current operations and increase their market shares, and that the constraint imposed by the conduct of existing competitors would be sufficient to ensure that the merged entity would not acquire or strengthen a dominant position in any market. Any attempt by the merged entity to raise prices or lower output or quality would lead to its competitors increasing production and eroding the merged entity's market share.
- 77 Commission staff agree that existing competitors could expand their existing operations and would be in a position to provide a constraint on the merged entity.
- 78 Danaflex was of the opinion that it would be in a position to substantially increase its market presence following the merger. Such expansion would necessarily involve increasing its supply of plastic tubing from American National Can, possibly increasing the number of conversion lines operating, increasing staff numbers and so on. However, it was not considered that there would be any particularly onerous barriers to expansion.
- 79 []
- 80 The General Manager for Globus, Mr Ian Burdan []
- 81 The end users contacted by Commission staff held differing opinions as to the ability of existing competitors to meet their vacuum shrink packaging requirements. AFFCO did not consider that Danaflex was a potential alternative supplier at the present time. []. However, it was accepted that following the merger, American National Can, (through Danaflex) could take a greater interest in the New Zealand market. AFFCO did not consider that Globus would have the capacity to be able to meet AFFCO's very large shrink packaging requirements.

- 82 PPCS has recently moved to a single supplier, Grace, for all of its flexible packaging requirements. It did not regard Danaflex and Globus as significant competitors in the market for vacuum shrink packaging, and expressed some concern that the merged entity would be the only large supplier of vacuum shrink packaging in New Zealand. PPCS did not consider that Danaflex or Globus would be able to meet all of the meat company's shrink packaging requirements, in terms of both volume and quality.
- 83 Alliance currently purchases vacuum shrink packaging from both Trigon and Grace. Alliance did not perceive any problems with accessing vacuum shrink packaging following the merger. While acknowledging that Danaflex's shrink bag product was of a comparable standard to that of the larger market players, doubts were raised about the ability of a smaller player such as Danaflex to satisfy Alliance's high volume and quality demands.
- 84 Similarly, Richmond's shrink packaging suppliers are principally Trigon and Grace. Richmond expressed doubts about the ability of the smaller market participants to supply all of Richmond's shrink packaging requirements. There was also concern raised about the resources available to Danaflex and Globus for investment in research and technology.
- 85 The New Zealand Dairy Board expressed no concerns about the likely competition effects on the dairy industry. The main type of shrink packaging used in the industry, for the packaging of cheese, is predominantly supplied by Grace. Trigon does not have a comparable product. As there would be no aggregation in relation to this product, it was considered that the merger would not impact on the dairy industry.
- 86 In addition, there are other suppliers in the flexible packaging industry, such as Transpak and Holmes, supplying a range of cheese packaging products to the dairy industry. However, it is again noted that these products (for example, non-shrink pouches) are not considered direct substitutes for shrink packaging as they do not provide a "shrink" function.
- 87 Some of the smaller meat companies considered that the Danaflex and Globus would be able to meet their shrink packaging requirements. For example, Canterbury Meat Packers Ltd believed that either of the smaller suppliers could provide the necessary products, and levels of quality and service demanded by the meat company. It was noted that while Globus has not shown any interest in supplying South Island customers in the past, that company has recently demonstrated its willingness to supply into the South Island.

88 Canterbury Meat Packers Ltd expressed doubts about the smaller suppliers' total supply capacities. For example, while Danaflex might be in a position to meet Canterbury Meat Packer's needs, if other meat companies were also to place substantial orders with Danaflex, the company would be unlikely to be able to supply all its customers requirements.

89 Concern was also expressed by a number of end users about the potential reduction in research and development that may occur as a result of the merger. It was noted that Grace and Trigon have invested a great deal of time and money in research and development; for example, research into products specifically designed for the New Zealand export meat industry and product modifications to meet customer requirements. It was feared that any lessening of competition in the market would also see a reduction in this research and development.

90 Both Globus and Danaflex considered that they had the capacity to invest in research and development to meet the demands of the market. In particular, Danaflex noted that [

].

91 [

].

92 [

].

93 [

].

94 One interested party noted that [

].

95 [

].

96 Finally, the applicant has submitted that MAP systems will continue to act as a constraint on the merged entity. On the basis of discussions with other industry participants, staff are unable to give any significant weight to MAP systems (or other flexible packaging products) as providing a potential competitive constraint on the vacuum shrink packaging market or the combined entity. It does not appear that they are regarded as substitute products by the majority of end users.

Conclusion on Constraint from Existing Competition

97 Commission staff conclude that existing competitors in the vacuum shrink packaging market would provide some constraint on the merged entity. Danaflex and Globus could expand their vacuum shrink packaging operations within a relatively short period of time, although there are some doubts about the capacities of those smaller companies to meet the volume demands of the larger end users. []].

Constraint from Potential Competition

98 As the combined entity would face minimal competition from existing competitors, it is necessary to determine whether the new Sealed Air would be subject to significant constraints from the threat of market entry. Potential competition which could act as a constraint could come from either new entry to the market or imports. Before the Commission will consider that new entry will provide an adequate constraint on a combined entity so as to allay dominance concerns, such entry must be shown to be *likely*, of sufficient *extent*, *timely* and *sustainable* (the “*lets*” test).⁵

99 Flexible packaging materials for the food industry are supplied by a number of companies in New Zealand, and there are also a limited number of worldwide suppliers in countries such as the United States, Japan and Europe; for example, Viskase and American National Can in the United States; Asahi, Mitsubishi Chemicals and Kureha in Japan; and Dixie Union in Germany.

100 Sealed Air submits that two important dimensions of the flexible packaging industry in New Zealand are the global nature of the industry and the openness of the New Zealand economy. It is submitted that flexible packaging is part of an increasingly international market, and that there is increased competition (both existing and potential) as a result of this globalisation. Another feature of the industry is that there are “clusters” of competitors who supply specific products to particular groups of end users. Suppliers have chosen to target specific end users, and have developed flexible packaging products

to meet the packaging requirements of their particular customer group. For example, Trigon, Grace and Danaflex supply vacuum shrink packaging to the meat industry; Transpak and Holmes supply cheese packaging to the dairy industry.

- 101 The applicant argues that the global flexible packaging suppliers could expand their presence in or enter the New Zealand market with little difficulty, and that the constraint from this potential competition is significant. It is noted that while there are a number of overseas suppliers not currently participating in the New Zealand market, Commission staff were informed by Mr Dunlop that not all of these suppliers have shown an interest in entering the market.
- 102 Apart from potential competition from global suppliers, the parties to the proposal consider that a number of existing flexible packaging manufacturers have the appropriate plant and equipment to produce vacuum shrink packaging. The applicant identified a number of companies, including Transpak, Chequer and Holmes, which could expand their existing flexible packaging operations and diversify into the market for the supply of vacuum shrink packaging. It was argued that these other participants have the ability, with minimal investment, to enter the market by importing the plastic shrink tubing from an overseas supplier, and printing and converting it locally. The applicant estimates that it would take less than [] before a new market player could supply vacuum shrink packaging.
- 103 The applicant submits that the equipment necessary for the printing and conversion of plastic shrink tubing is common to most flexible packaging companies operating within New Zealand. It is also submitted that virtually every manufacturer of flexible packaging materials has a flexographic printing machine which could print the shrink bag tubing. Similarly, existing bagging machines could convert the tubing into finished bags []. Further, the cost of purchasing the required conversion equipment [] would be low.
- 104 On the basis of discussions with industry participants, it appears that entry into the shrink packaging market would require the setting up of an alternative conversion line rather than modification of existing machinery. It was estimated that a new conversion line could be set up at a cost of approximately [].
- 105 The applicant submits that there are no barriers to entry. It was noted that although there is a duty of 9% payable on the importation of film, there is a drawback of duty paid if the film is applied to export meat. Mr Dunlop also informed Commission staff that while

exporters can claim a duty refund on any packaging used for exported products, they may also get approval for the initial non-payment of the duty, subject to subsequent audit.

- 106 In relation to intellectual property rights, Commission staff were informed that the shrink technology is available from a number of global suppliers. There are some current patents applying to recent shrink technology developments, but patents on the shrink technology in general have expired.
- 107 A further barrier to successful market entry for a new entrant would be in establishing supply contracts with some of the major end users of shrink packaging. A new entrant would have to be able to prove its ability to meet an end user's volume and quality requirements, involving a considerable investment in time and money.
- 108 While entry barriers do not appear high for an entrant importing plastic tubing from an overseas supplier, entry barriers for an entrant wanting to manufacture its own plastic shrink tubing would be significantly higher, and entry on that scale would not appear to be likely.
- 109 Finally, it is noted that industry participants such as AEP, Chequer, Holmes and Securefresh did not have any major concerns in relation to the proposed merger. AEP []].

Constraint from Imports

- 110 The applicant submits that finished shrink bags could be imported into New Zealand, and it was noted that a number of market players including Danaflex, Globus and Trigon already do so. The viability of importing finishing shrink bags was considered feasible by some flexible packaging suppliers, but it was stated that importation would involve some logistical difficulties; for example, having to make advance orders and to hold increased inventories because of the longer supply chain. It was considered more practical for an industry participant to enter the market by importing the plastic tubing for printing and conversion.
- 111 Some of the meat companies contacted did not consider that direct importation of shrink bags would be feasible. Meat companies use a wide range of shrink bags which are generally product-specific and which often require complex printing. It was doubted whether these printing requirements could be adequately met by an overseas supplier.

- 112 The meat companies emphasised the importance of having access to a reliable supply of shrink bags of a high quality. As such, it was considered more desirable to have a reliable local supplier rather than having to depend on a supplier in another country. Further, it was noted that demand in the export meat market is unpredictable. At times, meat companies only have short lead times between receiving and despatching orders. It would not be practical or feasible to carry adequate stocks of all of the bag types and sizes that may be required in a particular season in order to meet these deadlines.
- 113 AFFCO considered that importing finished shrink bags was an option but that it would involve difficulties, particularly in relation to the printing requirements for the shrink bags. For example, MAF requires that each bag have the relevant plant designation number printed on it. Similarly, Huttons Kiwi considered that importing shrink bags was possible, but would involve difficulties such as longer lead times and the need to hold adequate stocks.
- 114 While importing finished shrink bags is possible, it is not seen as a particularly attractive option by either flexible packaging suppliers or end users. As such, it would not act as a significant constraint on the merged entity.

Conclusion on Constraint from Potential Competition

- 115 The Commission considers that entry which cannot be achieved within two years from initial planning is unlikely to be sufficiently timely to allow dominance concerns. Based on information provided by the parties and other market participants, it is considered that new entry could occur in a timely fashion.
- 116 With respect to the extent of entry, it would be necessary for any new entrant to secure supply contracts with end users in the meat and dairy industries in order to represent a sufficient constraint on the merged entity. This would be difficult given the larger end users' reluctance to switch to a supplier who has not yet established itself in the market. Assuming a new entrant gained support from these end users, entry could be sustainable.
- 117 Staff do not believe that entry into the market by a domestic manufacturer, extruding its own plastic shrink tubing for printing and conversion is likely, as the manufacturer would not have "a reasonable prospect of achieving a satisfactory return on investment"⁶ should it decide to enter the market. The costs and technological barriers associated with entry would be significant.

- 118 It is considered that entry into the market by an existing or new industry participant importing plastic shrink tubing from an overseas supplier is far more likely. There do not appear to be any barriers to importing plastic tubing, and conversion equipment is readily available. Consequently, competitors producing other types of bags could switch to producing vacuum shrink packaging within a relatively short period of time.
- 119 Accordingly, staff consider that potential entry to the market by an existing or new supplier converting and printing imported plastic tubing would act as a constraint on the combined entity. There is also the potential for an overseas supplier not yet represented in New Zealand to enter in its own right or for finished shrink bags to be imported into the country.

Countervailing Power of Buyers

- 120 The merger parties claim that the large meat companies in New Zealand, as their major customers, have considerable countervailing power in the market, and could exert this power in the event that the merged entity attempted to exert its own market power and raise prices. It was argued that [
-].
- 121 The applicant also submits that the merged entity's dependence on a small number of customers for a significant portion of its revenue will deter it from increasing prices or reducing the quality of its products or services. The applicant pointed out that the merged entity would be exposed to a significant loss in revenue if it was to lose even one of its customers to a competitor. As such, Trigon and Grace have been, and the merged entity will continue to be constrained by the conduct of the meat companies.
- 122 Mr Dunlop believed that larger end users had the ability to buy directly from overseas suppliers. It was considered that the shrink bags could either be printed overseas, or be sourced from overseas and printed in New Zealand by a local printer. A further possibility for the major meat companies would be to foster another manufacturer (as was done with Southern Packaging in Christchurch some years ago). However, it was acknowledged that the business climate was considerably different at that time, as import barriers were high, and the likelihood of it happening in the present deregulated market was not great. Mr Dunlop also noted that while the smaller meat companies may not be in a position to import vacuum shrink packaging themselves, their needs could be met by the smaller market players.

- 123 While accepting that end users will have limited shrink packaging supply options available to them once the proposal is implemented, few of the end users contacted raised any concerns about the likely impact of the merger on competition in the market. It was generally agreed that the larger meat companies would be in a position to support an existing or new market participant if dissatisfied with the merged entity's performance. For example, although Richmond considered that it would have no alternative shrink packaging supplier in the short term (as it was doubted whether the smaller market players could meet Richmond's supply requirements), Richmond was of the view that the larger meat companies have had considerable bargaining power in the past and would be in a position to support an existing competitor or encourage a new entrant into the market. It was also noted that the "threat" of taking such action would have a considerable impact on the merged entity's behaviour.
- 124 AFFCO considered that it would be the largest user of shrink packaging in the meat industry, and has been able to use the threat of moving to another supplier in the past to negotiate favourable terms for its flexible packaging supplies. AFFCO has also established good business relationships with its suppliers, and it was anticipated that the merged entity would be interested in maintaining this relationship. However, if the merged entity was unable or unwilling to meet AFFCO's packaging and price demands, AFFCO believed that it was in a position to source shrink packaging from an overseas supplier or encourage an alternative supplier into the New Zealand market.

Conclusion on Countervailing Power of Buyers

- 125 Accordingly, staff conclude that end users, and specifically the larger meat companies, would be likely to act as a constraint on the combined entity.

OVERALL CONCLUSION

- 126 Although implementation of the proposal would lead to the combined entity having over [] market share of the vacuum shrink packaging market in New Zealand, staff consider that the proposed acquisition would not result, or would not be likely to result, in the combined entity acquiring or strengthening a dominant position in that market. There would appear to be sufficient competitive constraint from existing and potential suppliers of vacuum shrink packaging, and from the substantial countervailing power in the hands of end users, to eliminate concerns that the merged entity would acquire or strengthen a dominant position in the market.

- 127 Danaflex and Globus consider that they are well-positioned to expand their market presence if the merged entity was to attempt to exercise any undue market power. Viskase []. Market entry or expansion by overseas players such as Asahi or Mitsubishi Chemicals is also feasible, although it is noted that some overseas companies are not interested in entering the New Zealand market.
- 128 Furthermore, the larger meat companies possess a substantial degree of countervailing power, and while the acquisition would limit that power to a degree, it is considered likely that the meat companies will continue to be a constraining influence on market players.
- 129 Having regard to the factors set out in s3(9) of the Act and all other relevant factors, staff conclude that the proposed acquisition would not result, or would not be likely to result, in the combined entity acquiring or strengthening a dominant position in the following New Zealand markets:
- the market for the supply of bone protection packaging;
 - the market for the supply of thermoform film packaging;
 - the market for the supply of vacuum skin packaging;
 - the market for the supply of flexible packaging machinery; and
 - the market for the supply of vacuum shrink packaging.

RECOMMENDATION

- 130 It is recommended that, in terms of s 66(3)(a) of the Act, the Commission give clearance to the proposed acquisition subject to the undertaking given by Sealed Air Corporation [].

Jane Chilcott
Investigator

John Preston
Chief Investigator

Jo Bransgrove
Manager

¹ Pechiney Corporation is a large worldwide flexible packaging company.

² MAP systems or controlled atmosphere packaging (“CAP”) systems have a broad range of product applications. The packaging uses gas flush technology to remove the oxygen within the package and replace it with a controlled CO₂ gas environment. The major features of this packaging are extended shelf life and improved flavour.

³ The “permeable” vacuum shrink bag only needs to hold a ‘vacuum’ for a short time, between sealing and shrinking. Oxygen is able to permeate through the bag once the bag has shrunk against the frozen meat.

⁴ Refer Commerce Commission’s Business Acquisitions Guidelines, 1996, p17.

⁵ Business Acquisition Guidelines, 1996, pp19-20.

⁶ Business Acquisition Guidelines, 1996, p19.